

108TH CONGRESS
2D SESSION

H. R. 4139

To amend the Internal Revenue Code of 1986 to simplify the taxation of partnerships.

IN THE HOUSE OF REPRESENTATIVES

APRIL 2, 2004

Mr. HOUGHTON introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to simplify the taxation of partnerships.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as “State Business Law Con-
5 formity Act of 2004”.

6 **SEC. 2. REFERENCES TO GENERAL PARTNERS.**

7 (a) EXCLUSION OF CERTAIN ACTIVE BUSINESSES
8 FROM AT RISK RULES.—Subclause (I) of section
9 465(c)(7)(D)(ii) of the Internal Revenue Code of 1986

1 (defining qualified corporate partner) is amended to read
 2 as follows:

3 “(I) such corporation is not pro-
 4 hibited or limited under State law
 5 from participation in the management
 6 or business of the partnership.”.

7 (b) PAYMENTS TO RETIRING PARTNERS.—Subpara-
 8 graph (B) of section 736(b)(3) of such Code (relating to
 9 limitation on application of paragraph (2)) is amended to
 10 read as follows:

11 “(B) any portion of the retiring or de-
 12 ceased partner’s distributive share of partner-
 13 ship income was subject to tax under section
 14 1401.”.

15 (c) FOREIGN CURRENCY TRANSACTIONS.—Subclause
 16 (I) of section 988(c)(1)(E)(v) of such Code is amended
 17 to read as follows:

18 “(I) CERTAIN GENERAL PART-
 19 NERS.—The interest of a partner in
 20 the partnership shall not be treated as
 21 failing to meet the 20-percent owner-
 22 ship requirements of clause (iii)(I) for
 23 any taxable year of the partnership if
 24 for the taxable year of the partner in

1 which such partnership taxable year
2 ends—

3 “(aa) the partner is not lim-
4 ited as to participation in the
5 management or activity of the
6 qualified fund, and

7 “(bb) such partner (and
8 each corporation filing a consoli-
9 dated return with such partner)
10 had no ordinary income or loss
11 from a section 988 transaction
12 which is foreign currency gain or
13 loss (as the case may be).”.

14 (d) SPECIAL VALUATION RULES FOR GENERATION-
15 SKIPPING TAX.—Clause (ii) of section 2701(b)(2)(B) of
16 such Code (relating to partnerships) is amended to read
17 as follows:

18 “(ii) in the case of a limited partner-
19 ship, the holding of any interest as a part-
20 ner who is not limited as to participation
21 in management or activity of the partner-
22 ship.”.

23 (e) TAX MATTERS PARTNER.—Paragraph (7) of sec-
24 tion 6231(a) of such Code (defining tax matters partner)
25 is amended to read as follows:

1 “(7) TAX MATTERS PARTNER.—

2 “(A) IN GENERAL.—The tax matters part-
3 ner of any partnership is—

4 “(i) the partner designated as the tax
5 matters partner as provided in regulations,
6 or

7 “(ii) if there is no partner who has
8 been so designated, the partner having the
9 largest profits interest in the partnership
10 at the close of the taxable year involved
11 (or, where there is more than 1 such part-
12 ner, the 1 of such partners whose name
13 would appear first in an alphabetical list-
14 ing).

15 “(B) SELECTION BY SECRETARY.—If there
16 is no partner designated under subparagraph
17 (A)(i) and the Secretary determines that it is
18 impracticable to apply subparagraph (A)(ii), the
19 partner selected by the Secretary shall be treat-
20 ed as the tax matters partner. The Secretary
21 shall, within 30 days of selecting a tax matters
22 partner under the preceding sentence, notify all
23 partners required to receive notice under sec-
24 tion 6223(a) of the name and address of the
25 person selected.

1 “(C) RESTRICTION ON DESIGNATION OF
 2 PARTNER.—A partner may not be designated as
 3 a tax matters partner under subparagraph
 4 (A)(i) unless such partner is not limited as to
 5 participation in management or activity of the
 6 partnership.”.

7 (f) EFFECTIVE DATE.—The amendments made by
 8 this section shall apply to taxable years beginning after
 9 December 31, 2004.

10 **SEC. 3. REFERENCES TO LIMITED PARTNERS.**

11 (a) LIMITED ENTREPRENEUR.—

12 (1) IN GENERAL.—Subparagraph (A) of section
 13 464(e)(2) of the Internal Revenue Code of 1986 (de-
 14 fining limited entrepreneur) is amended by striking
 15 “other than as a limited partner”.

16 (2) CONFORMING AMENDMENTS.—

17 (A) Section 464(e) of such Code is amend-
 18 ed—

19 (i) by striking “limited partners or”
 20 in paragraph (1)(B),

21 (ii) by striking “a limited partner or”
 22 in paragraph (2).

23 (B) Section 1256 of such Code is amend-
 24 ed—

1 (i) by striking “limited partners or”
 2 each place it appears in subsections
 3 (e)(3)(B) and (f)(4),

4 (ii) by striking “a limited partner or”
 5 in subsection (e)(3)(C), and

6 (iii) by striking “limited partner or”
 7 both places it appears in the heading and
 8 text of subsection (e)(4)(A)(i).

9 (C) Section 1258(d)(5)(C) of such Code is
 10 amended—

11 (i) by striking “limited partner or” in
 12 the matter preceding subclause (i),

13 (ii) by striking “limited partner’s (or
 14 limited entrepreneur’s) in subclause (i) and
 15 inserting “limited entrepreneur’s”, and

16 (iii) by striking “partners and lim-
 17 ited” in the heading.

18 (b) PASSIVE LOSS RULES.—

19 (1) Subsection (h) of section 469 of such Code
 20 is amended by striking paragraph (2) and by redes-
 21 ignating paragraphs (3), (4), and (5) as paragraphs
 22 (2), (3), and (4), respectively.

23 (2) Subparagraph (A) of section 469(c)(7) of
 24 such Code is amended by striking the last sentence.

1 (3) Paragraph (6) of section 469(i) of such
 2 Code is amended by striking subparagraph (C) and
 3 by redesignating subparagraph (D) as subparagraph
 4 (C).

5 (4) Subsection (f) of section 772 of such Code
 6 (relating to special rules for applying passive loss
 7 limitations) is amended to read as follows:

8 “(f) SPECIAL RULES FOR APPLYING PASSIVE LOSS
 9 LIMITATIONS.—

10 “(1) IN GENERAL.—If any person holds an in-
 11 terest in an electing large partnership other than as
 12 a partner described in paragraph (3)—

13 “(A) paragraph (2) of subsection (c) shall
 14 not apply to such partner, and

15 “(B) such partner’s distributive share of
 16 the partnership items allocable to passive loss
 17 limitation activities shall be taken into account
 18 separately to the extent necessary to comply
 19 with the provisions of section 469.

20 “(2) EXCEPTION.—Paragraph (1) shall not
 21 apply to any items allocable to an interest held as
 22 a partner described in paragraph (3).

23 “(3) PARTNER DESCRIBED.—For purposes of
 24 this subsection, a partner is described in this para-
 25 graph if the partner is a person whose participation

1 in the management or business activity of the part-
 2 nership is limited under applicable State law.”.

3 (c) EFFECTIVE DATE.—The amendments made by
 4 this section shall apply to taxable years beginning after
 5 December 31, 2004.

6 **SEC. 4. PARTNERSHIP INCOME ATTRIBUTABLE TO CAPITAL**
 7 **EXCLUDED FROM NET EARNINGS FROM**
 8 **SELF-EMPLOYMENT.**

9 (a) IN GENERAL.—Paragraph (13) of section
 10 1402(a) of the Internal Revenue Code of 1986 is amended
 11 to read as follows:

12 “(13) there shall be excluded the distributive
 13 share of net income of a partner attributable to cap-
 14 ital;”.

15 (b) PARTNERSHIP INCOME ATTRIBUTABLE TO CAP-
 16 ITAL.—Section 1402 of such Code is amended by adding
 17 at the end the following new subsection:

18 “(1) PARTNERSHIP INCOME ATTRIBUTABLE TO CAP-
 19 ITAL.—

20 “(1) IN GENERAL.—For purposes of subsection
 21 (a)(13), the following amounts shall be treated as in-
 22 come attributable to capital—

23 “(A) the amount, if any, in excess of what
 24 would constitute reasonable compensation for

1 services rendered by such partner to the part-
2 nership, and

3 “(B) an amount equal to a reasonable rate
4 of return on unreturned capital of the partner
5 determined as of the beginning of the taxable
6 year.

7 “(2) DEFINITIONS.—For purposes of paragraph
8 (1)—

9 “(A) UNRETURNED CAPITAL.—The term
10 ‘unreturned capital’ means the excess of the ag-
11 gregate amount of money and the fair market
12 value as of the date of contribution of other
13 consideration (net of liabilities) contributed by
14 the partner over the aggregate amount of
15 money and the fair market value as of the date
16 of distribution of other consideration (net of li-
17 abilities) distributed by the partnership to the
18 partner, increased or decreased for the part-
19 ner’s distributive share of all reportable items
20 as determined in section 702. If the partner ac-
21 quires a partnership interest and the partner-
22 ship makes an election under section 754, the
23 partner’s unreturned capital shall take into ac-
24 count appropriate adjustments under section
25 743.

1 “(B) REASONABLE RATE OF RETURN.—A
 2 reasonable rate of return on unreturned capital
 3 shall equal 150 percent (or such higher rate as
 4 is established in regulations) of the highest ap-
 5 plicable Federal rate, as determined under sec-
 6 tion 1274(d)(1), at the beginning of the part-
 7 nership’s taxable year.

8 “(3) REGULATIONS.—The Secretary shall pre-
 9 scribe such regulations as may be necessary to carry
 10 out the purposes of this subsection.”.

11 (c) EFFECTIVE DATE.—The amendments made by
 12 this section shall apply with respect to services performed
 13 in taxable years beginning after December 31, 2004.

14 **SEC. 5. REPEAL OF ABILITY TO ELECT LARGE PARTNER-**
 15 **SHIP REPORTING RULES.**

16 (a) IN GENERAL.—Paragraph (2) of section 775(a)
 17 of the Internal Revenue Code of 1986 (relating to election)
 18 is amended by adding at the end the following: “No elec-
 19 tion under this subsection shall be made after December
 20 31, 2004.”.

21 (b) EFFECTIVE DATE.—The amendment made by
 22 this section shall apply to partnership taxable years begin-
 23 ning after December 31, 2004.

○